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USAID FOR ANE/MEA MCLOUD AND RILEY
TREASURY FOR SCHINDLER, BAUKOL, MATHIASON AND DENNIS
COMMERCE FOR 4520/ITA/ANESA/OBERG

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TAGS: ECON EINV EFIN EG
SUBJECT: MOODY'S DOWNGRADES EGYPT

¶11. (U) Moody's Investors Service downgraded its ratings of several categories of Egypt's debt on June 23. In particular, Moody's changed the outlook on Egypt's Bal foreign currency government bond from stable to negative and it changed the local currency bond rating from Baa3 to Bal while preserving its negative outlook.

¶12. (U) Moody's largely cites rising inflation behind the move. While inflation is rising across the region, it has hit Egypt particularly hard, and analysts are increasingly expecting inflation to remain high through much of 2008. The y-o-y data of 20% in May is one of the highest levels Egypt has seen and it is markedly higher than the peers in Egypt's comparator class. Egypt also has the highest public debt burden and widest fiscal deficit of countries in its investor peer class. In response to social pressures, the government has increased the subsidy bill and wages, both of which contribute to an already strained fiscal position.

¶13. (U) Moody's notes that the high inflation has contributed to some social vulnerabilities, and notes that for the outlook to stabilize, there would need to be a reduction in inflation and reassurance that the fiscal and social risks were being contained.

¶14. (U) Egypt's stock exchange has been suffering since May 5 when new revenue measures were announced, several of which will increase tax burdens on major industries listed on the exchange. This week, the downward movement has continued with the Moody's downgrade and the announcement that the GOE had not accepted any of the offers for the Banque du Caire privatization (septel). The market is down 2.25 percent this week, and 15.5 percent since May 5.

¶15. (SBU) The vast majority of Egypt's debt is held domestically and the majority of that is held by the state-owned banks. Most banks in Egypt hold debt until maturity as the secondary market is undeveloped and state-owned banks consider this debt to be risk free. Hence, the impact of the downgrade may not be huge, but it should have some impact on the government's borrowing costs. A senior EFG-Hermes investment bank analyst says, "The downgrade may have an impact on yields on local and foreign government debt, and this may affect pricing on the Eurobond planned for this year." Mohamed Assad in the Finance Ministry indicated surprise by the decision, but also was fairly dismissive of its impact. He said, "The inflation is all imported -- why should we be punished for that?" However, he agreed that it could affect any possible international offerings later in the year.

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